



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
SECURITIES MARKET DIVISION

Before the Executive Director (Securities Market Division)

In the matter of Show Cause Notice issued to

Sherman Securities (Private) Limited

Under Rule 8 read with Rule 12 of the Brokers and Agents Registration Rules, 2001 ("the Brokers Rules") and Section 28 of the Central Depositories Act, 1997 (the CDC Act)

Number and date of Notice	SMD-SOUTH/SCN/98/07 dated August 01, 2007
Date of hearing	September 12, 2007
Present	Mr. Mirza Mehmood Ahmad
Date of Order	November 02, 2007

ORDER

1. This order shall dispose of the proceedings initiated through Show Cause Notice SMD-SOUTH/SCN/98/07 dated August 01, 2007 ("**Show Cause Notice**") issued to Sherman Securities (Pvt.) Limited (the "**Respondent**") by the Securities and Exchange Commission of Pakistan (the "**Commission**") under Rule 8 of the Brokers Rules for violation of Rule 12 of the Brokers Rules and Clause A5 of the code of conduct contained in the Third Schedule to the Brokers Rules and under section 28 of the CDC Act.
2. Brief facts of the case are that the Respondent is a member of the Karachi Stock Exchange (Guarantee) Limited (the "**Exchange**") and is registered with the Commission under the Brokers Rules. An enquiry was initiated by the Commission in exercise of its powers under Section 21 of the Securities and Exchange Ordinance, 1969 ("**1969 Ordinance**") and A. F. Ferguson & Co. ("**the Enquiry Officer**") was appointed as the Enquiry Officer under the above mentioned section inter alia:
 - a) to enquire into the dealings, business or any transaction by the Respondent during the period from April 1, 2006 to June 15, 2006 ("**the Review Period**");
 - b) to identify any and all the acts or omissions constituting the violation of the 1969 Ordinance and the Rules made thereunder; and

- c) to identify violations of any other applicable laws, including but not limited to the Brokers Rules and Regulations for Short Selling under Ready Market, 2002 ("**2002 Regulations**") and the Central Depository Company of Pakistan Limited Regulations ("**CDC Regulations**") read with the CDC Act.

3. The findings of the Enquiry Officer revealed several instances of potential non compliances with applicable laws and regulations. A copy of the Enquiry Officer's report was sent to the Respondent under cover of a letter dated April 30, 2007 which required the Respondent to provide explanations on the observations of the Enquiry Officer together with supporting documents.
4. After perusal of the Respondent's replies to the above mentioned letter, which did not adequately explain the position, a Show Cause Notice was issued to the Respondent under Rule 8 of the Brokers Rules and under section 28 of the CDC Act, stating that the Respondent has prima facie contravened Rule 12 of the Brokers Rules read with Clause A5 of the code of conduct contained in the Third Schedule to the Brokers Rules and requirements of the CDC Regulations. Rule 12 of the Brokers Rule and clause A5 of the code of conduct are reproduced as under:

Rule 12- " A broker holding a certificate of registration under these rules shall abide by the code of conduct specified in the Third Schedule"

Clause A5 of the code of conduct-"A broker shall abide by all the provisions of the Act and the rules, regulations issued by the Commission and the stock exchange from time to time as may be applicable to them".

5. The Respondent was called upon to show cause in writing within seven days and appear before the Executive Director (SMD-South) on September 12, 2007 for a hearing, to be attended either in person and/or through an authorized representative.
6. The hearing was held on September 12, 2007 which was attended by Mr. Mirza Mehmood Ahmad, the Representative of the Respondent who submitted a written reply and argued the case.
7. A summary of the contentions that were raised by the Respondent in the written reply / during the hearing and findings and conclusions of the Commission on the same are as follows:



8. Blank Sales

- 8.1 In terms of Regulation 4 of the 2002 Regulations, blank sales are not permissible. The findings of the Enquiry Officer revealed 12 instances of blank sales during the Review Period.
- 8.2 The Respondent made the following submissions on this Issue ("**Issue No. 1**"):
- The Respondent pleaded that 11 out of 12 instances pertained to a single customer who claimed to be maintaining a CDC investor account. The customer used to instruct execution of a sale order and undertook to deliver securities to the broker. Later, the said customer used to square up his position before the end of trading. The practice continued until the Respondent upon direction of the Commission enquired from the customer about his CDC investor account and he was unable to prove the existence thereof and accordingly his account was closed and the matter was informed to the Commission.
 - In respect of remaining 1 instance, the Respondent pleaded that the same was a result of error.
- 8.3 I have Considered the contentions of the Respondent and am of the view that the above represents serious flaws in the internal control procedures of the Respondent as the existence of the CDC investor account was not ensured at the time of opening of the account thereafter which allowed the customer to make short sales until the matter was looked into by the Commission.
- 8.4 Considering the above facts and the contentions of the Respondent, it is established that on 12 occasions blank sales have been made in violation of Regulation 4 of the 2002 Regulations. In terms of Rule 8 of the Brokers Rules, more particularly sub rule (ii), sub rule (iii) and sub rule (iv) thereof, where the Commission is of the opinion that a broker has inter alia failed to comply with any requirements of the Securities & Exchange Commission of Pakistan Act, 1997 or the 1969 Ordinance or of any rules or direction made or given thereunder and/ or has contravened the rules and regulations of the Exchange and/or has failed to follow any requirement of the code of conduct laid down in the Third Schedule, it may in the public interest, take action under Rule 8(a) or (b) of the Brokers Rules.
- 8.5 In light of the above i.e. the fact that the Respondent made blank sales, the Respondent has violated the 2002 Regulations thereby attracting sub rule (iii) of Rule 8 of the Brokers Rule and has also failed to comply with Clause A5 of the code of conduct contained in the Third Schedule to the Brokers Rules, thereby attracting sub rule (iv) of the Rule 8 of the



Brokers Rule. Accordingly, a penalty of Rs. 10,000 (Rupees Ten Thousand) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules

9. Missing Account Opening Forms

9.1 In terms of Regulation 74 of the General Rules & Regulations of Karachi Stock Exchange (Guarantee) Limited ("**KSE Regulations**") it is provided that:

"The Members of the Exchange shall adopt the Standardized Account Opening Form, attached as Form-I to these Regulations, for their new Account Holders with immediate effect and for the existing operating accounts, the same shall be brought into conformity with Standardized Account Opening Form effective from March 31, 2004".

9.2 Findings of the Enquiry Officer revealed that the Account Opening Forms of 62 customers were not available with the Respondent.

9.3 The Respondent made the following submissions on this Issue ("**Issue No. 2**"):

- The Respondent contended that majority of these forms pertained to old and inactive clients and that measures had been taken now to ensure submission of updated account opening forms by all its customers.

9.4 Since no evidences were submitted by the Respondent in support of its claim, it is established that the Respondent failed to comply with the requirements of Regulation 74 of the KSE Regulations, thereby attracting sub rule (iii) of Rule 8 of the Brokers Rule and has also failed to comply with Clause A5 of the code of conduct contained in the Third Schedule to the Brokers Rules, thereby attracting sub rule (iv) of the Rule 8 of the Brokers Rule. Accordingly, a penalty of Rs. 5,000 (Rupees Five Thousand) is hereby imposed on the Respondent under Rule 8 (b) of the Brokers Rules.

10. CDC Balance statements

10.1 In terms of Regulation 6.2A.1 of the CDC Regulations, it is provided that:

"Every Participant shall send by the 10th day of every month to all Sub- Account Holders maintaining Sub-Accounts under the control of such Participant Holding Balance statements showing the number of every Book-entry Security entered in



every such Sub-Account as of the end of the preceding month. Such Holding Balance statements shall be generated from the CDS and shall be sent to the Sub-Account Holders in the manner set out in Regulation 2.6.4."

- 10.2 Findings of the Enquiry Officer revealed that the Respondent did not have a practice to send the CDC Balance statements to all of its customers by the 10th of each month as required under the CDC.
- 10.3 The Respondent made the following submission on this Issue ("**Issue No. 3**"):
- The Respondent contended that the CDC Balance statements are available on the Respondent's website where the customers can access their account details using their authenticated user ID and password. For this purpose, letter of online confirmation of customers' trading, delivery and accounts is taken by the Respondent at the time of opening of accounts.
- 10.4 I have considered the contentions of the Respondent and am of the view that updating the customers' details on the website cannot be deemed to be a substitute of the requirements of Regulation 6.2A.1 of the CDC Regulations, since the CDC balance statements downloaded from the CDS provide an independent and authenticated source of information to a client. However, considering the practical difficulties in sending the CDC balance statements to all of the clients of the Respondent, including the dormant accounts, I am inclined, on this occasion, to take a lenient view in the matter and will not take any punitive action under section 28 of the CDC Act. As such, I believe a 'caution' in this instance to the Respondent would suffice and I would further direct the Respondent to ensure that full compliance is made of all the rules and regulations in future for avoiding any punitive action under the law.
11. In view of what has been discussed above, I am of the considered view that no punitive action is necessary in relation to Issue No. 3 and a simple caution will suffice. As regards Issues No. 1 and 2, as stated above, penalties of Rs. 10,000 (Rupees Ten Thousand) and Rs.5,000 (Rupees Five Thousand) are imposed respectively, which should be deposited with the Commission not later than fifteen (15) days from the date of receipt of this Order



Zafar Abdullah
Executive Director
Securities Market Division